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THE PARADOXES OF POVERTY

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Miniconference on

"The Paradoxes of Poverty"

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Executive Summary

"The fact that growth is a tremendous force in eliminating poverty -- is really essential -- is something that we have learned," said Jagdish Bhagwati in an IRIS-sponsored miniconference held on May 27 at the State Department. In reviewing his own involvement in development work over four decades, Bhagwati described a "sea change" in development thinking over the past ten years, with the abandonment of "the notion that growth contributes to poverty."

This thinking was based on the idea that the normal pattern of economic development involves first a widening of the income distribution, followed only many decades later by a narrowing. However, in Bhagwati's involvement in planning in India in the 1950s, growth was viewed "as the natural strategy, as a pull-up strategy, not as a trickle-down strategy, not as a conservative option but as a radical option." Rapid accumulation would "pull people on board" from underemployment. Growing, creating jobs was seen not a spillover effect that just happens inadvertently, but the central goal of development.

However, Bhagwati feared that many people still think that anyone concerned with growth or efficiency is incapable of understanding poverty. In Bhagwati's view, growth and the reduction of poverty are not at all incompatible, and one is the instrument of the other. Without growth, in the long run there is no way of generating the resources to improve the standard of living of the poor-

Donor options

Christopher Clague described three categories of donor humanitarian strategies to address poverty:

(1) providing goods and services directly to poor people, as in famine relief;

(2) spending resources directly on poor people to teach them how to cope better with their existing economic environment, by such means as adult literacy programs, microenterprise credit and training, and family planning activities:

and (3) spending resources to improve the economic environment for poor people by promoting policy reforms and institutional improvements.

However essential in coping with disasters and despite important local impacts, direct assistance was described as fundamentally limited in what it could accomplish. To improve the economic environment for most people, a project needs to be not only sustainable but replicable, and replicated in a wider area. In poor countries, policies and institutions are far from optimal, and they prevent the countries from extracting anywhere near as much production from their human and natural resources as would be possible under a better set of arrangements.

Bhagwati emphasized that whatever resources were invested in direct and indirect methods of assistance, there needs to be an institutional policy framework to maximize the return, as well as consideration of how to bias the growth process itself in terms of its impact on the poor. Clague noted the occasional divergence between nonmonetary measures of well-being, including indicators of health and education, and monetary ones, such as the income or consumption of the bottom portions of the income distribution. The experience of countries such as Cuba arid Sri Lanka show that economic growth is not necessary to improve the health and education of the poor, although highly desirable in its own right in part because it allows increases in consumption by the poor.

Education

Clague and Bhagwati identified primary education as a key factor in improving both growth and the distribution of income. The education of women in particular can make an enormous difference to gender equality and improving living standards. Also, the rethinking of population control issues obviously depends on the ability of women to participate. However, as Clague pointed out, expanding education by itself does not alleviate poverty. The economic environment can be so bad that people are unable to convert their skills into higher standards of living. Most countries in Sub-Saharan Africa have experienced considerable educational expansion, while per capita income for the region has declined since the middle 1970s.

Causes of Poverty

Mancur Olson argued that much of the poverty in the Third World results from policies and arrangements chosen by well-placed individuals and well-off groups in their own interests. High levels of regulation in many Third World countries were seen as partly the product of corruption, with the bureaucracy seeking to make illegal all sorts of transactions or to require permission or licenses, thereby opening up the possibility of receiving a bribe. In addition, urban, well-established, and well-to-do groups can get favorable regulations and protections advantageous to them, but often disadvantageous to the society. Large inefficiencies in the interest of some individuals and groups are particularly adverse in their effect on poverty because the poor are almost never politically organized, particularly given Third World problems of transportation and communication, and low levels of literacy. Agricultural pricing policies of most developing countries, which subsidize the relatively advantaged urban population at the expense of the mass of poor farmers, also support this view.

Further, if the capacity to get favors out of government is greater in the higher reaches of the social order than it is in the lower reaches, disproportionately it would be the high-ranking people that would be part of the open, legal, governmental system and the poor people who would be outsiders. And, of course, the informal sectors in the Second and Third Worlds are disproportionately made up of the poor. In Olson's view, if the system is stacked against poor people, and if it has, in addition, various systematic inefficiencies that reduce the rate of innovation and the efficiency of resource allocation, then the poor are not helped decisively and in the long run by giving them a little bit of resources.

Market vs. State

Bhagwati also emphasized the role of markets as a powerful tool in development. Although markets still lead to unequal outcomes, Bhagwati described "a great lesson . . . of the last twenty years was that when you allocate through the market, the poor have a much better chance of getting at it than when the state does the allocation. Because when the state does it, it usually goes to the rich. That is a simple political fact of life." Bhagwati suggested that the contribution of Adam Smith is central to development, with markets being a revolutionary means of overcoming oligarchic, non-participatory systems in which mercantile and landed interests predominate.

According to Robert Klitgaard, the development challenge for the last decade was how to get the macro institutions of society right in terms of providing multi-party democracies and basic rights for people, restoring monetary stability, and liberalizing markets. Klitgaard described the current challenges as improving market institutions for people who have been systematically left out by them, and improving non-market institutions, especially governments, through information, incentives, competition, anti-corruption efforts, and hardening of budget constraints. Both markets and states will malfunction when institutions are bad, particularly when information and incentives are bad. Klitgaard described the idea of institutional economics as the creation of property rights and incentives so that purely redistributive behavior is redirected toward production.

Klitgaard used the examples of several projects -- the milk market in India, rural banking in Indonesia, and the Bolivian social emergency fund -- in which initial failure was redeemed by micro-level reforms. These reforms included the development of information at the local level, decentralization of authority, payment of government officials according to results, and incentives for the people in the bureaucracy to visit rural areas.

Beyond a good set of economic policies. countries need to develop the right economic institutions, including property rights, contract enforcement mechanisms, and the political rules for selecting leaders and government policies. Getting prices and macroeconomics right is not sufficient for economic growth if countries do not also develop appropriate legal and regulatory frameworks that protect property rights and contract enforcement.

Clague noted that despite widespread conceptions to the contrary, secure property rights and effective contract enforcement mechanisms are not in themselves inegalitarian institutions. These perceptions derive from the image of rich property owners enforcing property rights or contract provisions against poor tenants, workers, borrowers, or consumers. However, these institutions have powerful equality-promoting effects. In the first place, they enable individuals with only a little property and without political connections to make investments in themselves and in their small enterprises. Fair and transparent procedures for property, contracts, and government regulation of business open the way for competition in many areas of economic life from low- and middle-income people. In the second place, these institutions promote the accumulation of physical and human capital, which raises wages. Thus the reforms in policies and institutions that would increase the rate of growth are largely the same as those that would raise the welfare of the poor.

Reformers face the determined opposition of entrenched interests that benefit from inefficiency-promoting policies. Where donors can he particularly helpful is in aiding reformers to expose to public awareness the real consequences of existing policies and arrangements. In discussing the conditionality issue, Bhagwati argued that international institutions could play an important role in promoting better policies in developing countries However, Rhagwati noted two difficulties: Governments may depend upon nor having the reforms, and attempts to transplant cultural norms -- such as specific views on labor or environmental standards -- could be counterproductive. Such moves could create more inequality, less accumulation, and less impact on poverty simply because of most of the poverty is outside those sectors where these measures would be effective -- in rural areas, for example.

Democracy and Growth

The favored view used to be that democracy was a handicap to development, and it was feared that Communist countries would grow faster than democratic ones because they could accumulate capital far more quickly. However. this view ignored the effects of incentives and participation on how much you get out of what you invest. That is where democracies come out ahead, in Bhagwati's view, who argued that democracy really is an instrument for development. Bhagwati also suggested that the ability to adopt growth-promoting policies depends to a high degree on the initial distribution of assets. He traced part of the economic success of Korea and Taiwan to Japanese-imposed land reform, in addition to high literacy rates, an ethos about catching up with the outside world, and the development of export industries. Bhagwati questioned Clague's suggestion that these countries' economic success was partly due to their authoritarian character, which enabled frank labor-repressing policies to support the growth of manufacturing.

In concluding the conference, Bhagwati emphasized how development work had been informed by experience and research over the past thirty years, particularly compared to the time of his early work in the field, when development specialists were "guided by a priori models, many of which turned out to be quite wrong."

Paradoxes of Poverty: What Succeeds in Reducing Poverty?

Christopher Clague

When people who have their physical needs met see pictures of people in other countries suffering from malnutrition, preventable illness, lack of shelter and other manifestations of extreme poverty, there is a natural urge to try to alleviate that poverty. This motivation is one of the forces underlying the programs of foreign assistance that are carried out by all the highly developed countries of the world. At the same time, the urge to help alleviate the suffering of people in other countries has to compete with other claims on resources. so that the funds available for humanitarian assistance fall far short of what is needed to eliminate extreme poverty in the foreseeable future. There arises, then, a problem of allocation: How should foreign assistance be allocated in pursuit of the humanitarian objective of alleviating poverty in the low- and middle-income countries of the world?

The first question to be addressed in analyzing this problem is the determinants of poverty itself. What are the obstacles to reducing poverty in poor countries? The answer to this question depends somewhat on what we mean by poverty and how we measure it. In particular, it depends on whether we focus on monetary measures of consumption or on nonmonetary measures of the well-being of the poor, such as literacy, malnutrition, and infant mortality. These issues, and the connection between economic growth and poverty reduction, are discussed in the next section. The next question concerns the determinants of economic growth and distribution of the benefits of growth. What are the obstacles to faster and more equitable growth? Finally, what role can foreign assistance play in alleviating these obstacles? These questions are taken up in subsequent sections.

I. Economic Growth, Distribution, and Poverty

One way of assessing the well-being of the poor in a country is to look at indicators of health, morbidity, malnutrition, literacy and primary education. Dramatic improvements in such measures indicate that the poor are likely to be better off in important aspects of their lives. Another way of gauging changes in the extent of poverty is to look at the evolution of the income or consumption of the bottom portions of the income distribution. Since the countries that have done well on the nonmonetary measures are not identical to the ones that have done well on the monetary ones, we need to pay attention to both sets of measures.

This point is made forcefully in a recent book by Jean Dreze and Amartya Sen, Hunger and Public Action. One illustrative table (Table 10.3) from that book is reproduced here. It shows the ten countries that experienced the largest percentage reduction in under-age-5 mortality rate in the 1960-85 period. While this is only one of the nonmonetary indicators of the well-being of the poor, they point out that the picture conveyed by this one is representative for these countries of other such indicators as well. They make a distinction between two strategies for poverty reduction: growth-mediated security and support-led security. In the former, the proceeds of economic growth are used, through both the private and public sectors, to alleviate poverty, while in the latter, public resources are used for employment creation, health and education services, and transfers without waiting for economic growth to make more resources available (They have a third category of "aimless growth", in which no attention is paid to redistribution or poverty reduction.)

Table 10.3 Proportionate reduction in USMR (1960–1985): the top ten countries[a]

Country	Percentage reduction in USMR	Percentage growth rate of GNP/capita		GNP per head (US dollars)	Level of USMR
	(1960–85)	(1960–82)[b]	(1965–85)	(1985)	(1985)
Hong Kong	83	7.0	6.1	6,230	11
Chile	82	0.6	–0.2	1,430	26
UAE	82	*–0.7*	n/a	19,270	43
Costa Rica	81	2.8	1.4	1,300	23
Kuwait	80	*–0.1*	–0.3	14,480	25
Cuba	78	n/a	n/a	n/a	19
Singapore	76	7.4	7.6	7,420	12
China	75	*5.0*	4.8	310	50
Jamaica	72	0.7	–0.7	940	25
South Korea	71	6.6	6.6	2,150	35

[a] Excluded from the comparison are the countries of Eastern and Western Europe, Japan, New Zealand, Australia, USA, USSR, and Canada.
[b] In this column, figures in italics are for a period not exactly corresponding to 1960–82, due to [illegible] of data for the early 1960s (see *World Development Report 1984*, Table 1).
Source: UNICEF (1987*a*), Table 1; *World Development Report* (1984, 1987), Table 1.

Of the ten countries in Table 10.3, five followed the "support-led" strategy: Chile, Costa Rica, Cuba, China, and Jamaica. All of these countries have enacted and implemented programs to provide social services to virtually the entire population, and these public expenditures have contributed importantly to the improvement in literacy, nutrition, primary enrollment, and under-5 mortality. The authors mention that Sri Lanka has also followed a support-led strategy and has achieved extraordinary levels of these indicators considering the low income level of the country. Sri Lanka is not in the top ten countries in percentage reduction of under-5 mortality because dramatic reductions took place in the decades prior to 1960.

These examples illustrate the point that economic growth is not necessary to improve the health and education of the poor. But of course economic growth is highly desirable in its own right, in part because it permits increases in the consumption level of the poor. We next turn to the relationship between growth and the consumption of the poor.

It is widely believed that redistribution and growth are in severe conflict, and that policy makers must choose between these two goals. Some years ago, Arthur Okun wrote an influential book, Equality and Efficiency: The Big Tradeoff, which was premised on the existence of the need to choose between them. While it cannot be denied that these two goals are sometimes in conflict, it is also the case that in many circumstances there is no conflict at all. Let us consider the policies that the World Bank recommends for reducing poverty in poor countries (see World Development Report 1990). These include the following:

a. investing in people: education, especially primary education, and public health measures such as immunizations and clean water supply;
b. agricultural research and extension;
c. rural infrastructure, including maintenance of roads and irrigation facilities;
d. outward-oriented trade policy;
e. stable macroeconomic policies;
f. avoiding financial repression and developing financial institutions that the poor can use.

All of these policies are cost-effective ways of using resources to increase the rate of growth. By and large these are the policies that have been followed in several Asian countries that have dramatically reduced poverty in recent decades. These countries include not only the dragons Taiwan and Korea, but also

Indonesia. Malaysia, and Thailand. (See Table 3.2 reproduced from the **WDR 1990, p. 41.)**

The relative importance of increasing income as opposed to redistributing it can be gauged by looking at another table from the **WDR 1990 (Table 3.7, from p. 48). This table compares the decline in poverty that** actually occurred in the countries from that which would have occurred if income distribution had remained unchanged. The table shows that in only two cases (Brazil and Costa Rica) of growth over a long period did actual poverty fall by less than the simulated poverty; in other words, only in these two cases did the income distribution turn adverse for the poor. In the other nine cases, the change in income distribution favored the poor.

These results and others indicate that the conflict between growth and equity is less severe than many people believe. A perception that used to be pervasive in the development community is the proposition referred to as the Kuznets inverted U-curve. Kuznets suggested several decades ago that the normal pattern of **economic** development from a low level would involve first a widening of the income distribution, followed only many decades later by a narrowing. Thus income inequality plotted against time would display **an inverted U-shape. Many early studies plotted a cross-sectional graph of inequality against the level of** per capita income. and this graph did tend to display the inverted U-shape. However, the time series studies of the World Bank, cited above, and others, show that rising inequality in the early stages of development is by no **means inevitable and** does not even seem to be the general rule.

Table 3.2 Changes in selected indicators of poverty

countyand *period*	*Length of period (years)*	*Headcount index*		*Number of poor (millions)*		*Average income shortfall (percent)*	
		First year	*Last year*	*First year*	*Last year*	*Fin-t year*	*Last year*
Brazil (1960–80)[a,b]	20	50	21	36.1	25.4	46	41
Colombia (1971–88)[a]	17	41	25	8.9	7.5	41	38
Costa Rica (1971–86)	15	45	24	0.8	0.6	40	44
India (1972-83)	11	54	43	311.4	315.0	31	28
Indonesia (1970–87)	17	58	17	67.9	30.0	37	17
Malaysia (1973-87)	14	37	15	4.1	2.2	40	24
Morocco (1970-M)	14	43	34	6.6	7.4	46	36
Pakistan (1962-84)[a,b]	22	54	23	26.5	21.3	39	26
Singapore (1972-82)	10	31	10	0.7	0.2	37	33
Sri Lanka (1963–82)[a]	19	37	27	3.9	4.1	35	29
Thailand (1962–86)[a,b]	24	59	26	16.7	13.6	..	35

Note: This table uses country-specific poverty lines. Official or commonly used poverty lines have been used when available. In other cases the poverty line has been set at 30 percent of mean income or expenditure. The range of poverty lines, expressed in terms of expenditure per household member and in PPP dollars, is approximately $300–$700 a year in 1985 except for Costa Rica ($960), Malaysia ($1,420), and Singapore ($860). Unless otherwise indicated. the table is based on expenditure per household member. The headcount index is the percentage of the population below the poverty line. The average income shortfall is the mean distance of consumption or income of the poor below the poverty line, as a proportion of the poverty line.

a. Measures for this entry use income rather than expenditure.

b. Measures for this entry are by household rather than by household member.

Table 3.7 Poverty, economic growth, and recession

Country and period	Length of period (years)	Observed reduction in poverty (percentage points)[a]	Simulated reduction in poverty (percentage points)[b]	Annual growth of mean income or expenditure (percent)
Long-run growth				
Indonesia (1970-W)	17	41	35	3.4
Thailand (1962-86)	24	33	30	2.7
Pakistan (1962-84)	22	31	26	2.2
Brazil (1960-80)	20	29	34	5.1
Malaysia (1973-87)	14	23	19	4.0
Singapore (1972-82)	10	21	19	6.4
Costa Rica (1971-86)	15	21	22	3.5
Colombia (1971-88)	17	16	8	1.1
India (1972-83)	11	11	10	1.0
Sri Lanka (1963-82)	19	10	8	0.9
Morocco (1970-84)	14	9	1	0.2
Short-run recession	3			
Costa Rica (1983-86)	3	12	13	10.9
Indonesia (1984-87)		11	9	5.0
India (1977-83)	6	7	2	0.8
Malaysia (1984-87)	3	1	-1	-0.7
Pakistan (1979-84)	5	1	4	1.2
Colombia (1978-88)	10	-1	-1	-1.2
Côte d'Ivoire (1985-86)	'1	-1	-5	-5.4
China (1985-88)[c]	3	-4	5	6.7
Brazil (1981-87)	6	-5	1	0.9
Venezuela (1982-87)	5	-5	-6	-4.5
Thailand (1981-86)	5	-6	0	0.0
Costa Rica (1977-83)	6	-7	-8	-3.4
Yugoslavia (1978-87)	9	-7	-12	-2.9
Poland (1978-87)	9	-14	-17	-1.2

a. Absolute change in the headcount index on the basis of the definition of absolute poverty in the specific country.
b. The simulation assumes that the inequality of income remains unchanged.
c. Rural only.

II. What are the Obstacles to Economic Growth and to Effective Public Services?

Poverty can be reduced by a pattern of economic growth that encourages demand for labor and by effective public programs that provide education and health services to the poor. These strategies are not in as much conflict as many people believe. It is well documented that public spending on primary education produces a high social rate of return in less-developed countries (Psacharopoulos 1985). It seems likely that public programs that provide clean water and sewage disposal, immunizations, and family planning services also yield high rates of return if they could be property evaluated. Moreover, public provision for the very poor is not terribly expensive and need not impose much of a tax burden on the rest of the population. What is required for these public service prógrams is an effective administration and the political pressure to respond to the needs of the poor.

What is needed for a labor-intensive pattern of economic growth is a set of policies and institutions that provide appropriate incentives. The policies that are recommended by the World Bank and the IMF are well known. Some of them were listed in the previous section.

It is widely recognized that expanding education is key to reducing poverty. Education increases national productivity of labor, and expanding education to larger sections of the population tends to improve the income distribution. Education seems to have high social rates of return, based on studies of productivity of farmers and earnings of workers of all types, including informal sector workers, where credentialism is not a factor. Primary education seems to have the highest rates of return and it has the most clearly beneficial effects on the income distribution.

Yet expanding education by itself does not alleviate poverty. The economic environment can be so bad that people are unable to convert their skills into higher standards of living. This point is illustrated by the figures below, which were taken from the Human Development Report 1993.

It is striking that adult literacy has improved in Ghana and Madagascar, and enrollment increased in Nicaragua, while per capita income either declined sharply or failed to increase. Most countries in Sub-Saharan Africa have experienced considerable educational expansion, while per capita income for the region has declined since the middle 1970s. (World Bank, Adiustment in Africa).

Country Groups	Literacy (%)		Primary and Secondary Enrollment		Educational expenditures as % of GDP	
	1970	1990	1970	87-90	1970	1990
Least developed countries	29	45	29	42	1.3	2.8
Sub-Sahara	28	47	26	46	2.4	3.4
All LDCs	46	65	55	73	2.2	3.4
Ghana	31	60	52	58	3.8	3.4
Madagascar	50	80	50	53	2.3	1.9
Nicaragua	na	na	54	73	1.5	2.5

Country Groups	Per cap income PPP$	
	1960	1990
Least developed countries	580	740
Sub-Saharan Africa	na	na
All LDCs	950	2170
Ghana	1049	1016
Madagascar	1013	704
Nicaragua	1756	1497

A recent paper by Martin Baily (1994) makes the following observation. While a high level of education seems to be a necessary condition for rapid growth, the *rate of* growth of education does not correlate with the growth of output per worker. In fact, the simple correlation between these two growth rates is negative.

A message that IRIS has been putting forward is that in addition to a good set of economic policies, countries need to develop the right economic institutions. The word institutions is used here in the sense of the New Institutional Economics, that is, as rules of the game. These include property rights, contract enforcement mechanisms, and the political rules for selecting leaders and government policies. Getting the prices right and the macroeconomics right is not sufficient for economic growth if countries do not also develop an appropriate legal and regulatory framework that protects property rights and contract enforcement.

Despite widespread conceptions to the contrary, secure property rights and effective contract enforcement mechanisms are not in themselves inegalitarian institutions. These perceptions derive from the image of rich property owners enforcing property rights or contract provisions against poor tenants, workers, borrowers, or consumers. However. these institutions have some very powerful equality-promoting effects. In the first place, they enable individuals with only a little property and without political connections to make investments in themselves and in their small enterprises so that they can accumulate some wealth. Fair and transparent procedures for property, contracts, and government regulation of business open the way for competition in many areas of economic life from low- and middle-income people. In the second place, these institutions promote the accumulation of physical and human capital, which tends to reduce real interest rates and the premium on skill and to raise the wage of unskilled labor. Rather than thinking of these factor-price changes as trickle-down effects, they should be viewed as a waterfall, for the main force driving up the wage of unskilled labor is the accumulation of physical and human capital.

Thus the reforms in policies and institutions that would increase the rate of growth are by and large the same as those that would raise the welfare of the poor. Why then are they not implemented? It seems that the answer to this question lies in the realm of politics and the paradoxes of collective action. Those who would benefit from the reforms are often not aware of the need for them or are not able to organize collectively to bring them about. This question will be addressed by other speakers at this conference, and I will have a few more words on it in the next section when we discuss the possible role of donors in these reforms.

III. How Can Donors Help Countries to Alleviate Poverty?

In addressing this question, let us set aside other motivations for foreign assistance, such as concerns for national security (which may be promoted by fostering democracy or securing political alliances) or our own prosperity (which may be promoted by encouraging other economies to grow). Instead let us focus entirely on the humanitarian objective of alleviating extreme poverty. All donor humanitarian strategies can be divided into three categories: (1) providing goods and services directly to poor people, as in famine relief; (2) spending resources directly on poor people to teach them how to cope better with their existing economic environment, by such means as adult literacy programs, microenterprise credit and training, and family planning activities; and (3) spending resources to improve the economic environment for poor people by promoting policy reforms and institutional improvements.

While there is certainly a case for the first strategy in event of disasters, it seems clear that in the case of non-emergencies -- that is situations which are not markedly worse than in the past or in the future -- the payoff from the first strategy will be less than that from the other two. The end state toward which we aspire is not one of continuing transfers from rich to poor but rather one in which people and countries become able to lift themselves out of poverty. So the main allocation problem for donors boils down to choosing the mix of strategies (2) and (3). How much do we try to help poor people directly, as opposed to trying to improve the environment in which they are struggling to cope?

To be sure, the distinction between improving the environment and helping people to cope with their existing environment is somewhat fuzzy at the edges. A pilot project of rural development is typically carried out in a particular community and the immediate beneficiaries of a project are the participants, but if the project is successful, the facilitators will have learned something about how to extend the project elsewhere and the demonstration effect may contribute to emulation of the project by other communities. In this way a project may start off by helping a small number of people directly but may in the end improve the economic environment for a whole region or country. In this type of situation, there is still the issue of the relative emphasis to be placed on helping the direct beneficiaries versus structuring the project or choosing projects that offer the best chances of having a broad set of favorable consequences. This is related to but not identical with the issue of sustainability. In principle a project could produce benefits that are sustainable but limited in scope, as when the institutions for maintaining irrigation canals are improved in a particular community. In order to improve the economic environment for a large number of people, a project needs to be not only sustainable but replicable, and in fact replicated in a wider area.

The case for emphasizing strategies directed toward improving the economic environment for poor people is based on the assumption (among others) that in poor countries the policies and institutions (in the sense of the rules of the game) are far from optimal. These policies and institutions prevent the countries from extracting anywhere near as much production from their human and natural resources as would be possible under a better set of arrangements. A further assumption is that a better set of arrangements would tend to be self-sustaining. Thus policy and institutional reform offers countries an escape from poverty and stagnation into self-sustaining growth. This interpretation of the obstacles to development, which is widely accepted today, is quite at variance with earlier views on economic development, in which poverty itself was viewed as the major obstacle to increasing the rate of growth. In that view, temporary assistance which raised people's income was sufficient to enable them to save and to have fewer children and thereby to escape from poverty.

It is interesting to review the conclusions the World Bank has drawn from its experience in rural development projects and urban poverty projects (World Development Report 1990, pp. 131-3):

> "... Although there was always an awareness of the importance of an appropriate policy framework, finance was often granted in unpromising circumstances in the hope that governments would be encouraged to change their policies. As it turned out, the larger policy environment was perhaps the single most important factor in the success or failure of the projects. Government policies on prices, interest rates, and input supplies were frequently at variance with project objectives. Moreover, the projects themselves often proved ineffective levers for influencing overall national policies for agricultural development. Many tended to be successful "enclaves" within national agricultural systems that were still largely inefficient and inattentive to the needs of poor farmers.
>
> ... Project-level interventions, such as shelter projects, often do not have much influence on the overall urban policies of recipient countries. Some of the old planning and design criteria gave way to lower-cost solutions, but the laws, codes, and regulations that provide the framework for private housing development were generally left unchanged. The most recent assessment of the Bank's urban projects concluded that in most countries sites and services projects -- again like many rural development projects – became "enclaves." Rarely did governments establish programs independent of external donor support. As a result, the direct provision of shelter did not have the broad, long-

term impact on the sector that had been expected.

... Reducing poverty through aid calls for more than money. Building capacity is crucial. Donors have unduly neglected the institutional and managerial aspects of poverty-oriented projects and programs.... Donors often prefer to gather [their] experts in project units outside the normal bureaucratic structure. The result is that aid contributes less than it should to institution building in the recipient countries."

The Bank is using the word "institution" in the sense of an administrative unit in the government rather than in the New Institutional Economics sense of the rules of the game in the economy and in the political sphere. But the message is fundamentally the same. Large-scale reductions in poverty require reform of policies and institutions and donors should focus their attention on this broader picture.

The critical question is how donors can influence the reform of policies and institutions. In this task the role of ideas and of international experiences should not be underestimated. There has been a sea change of opinion in the world on the virtues of using markets in development. This change in opinion has been brought about by development experiences of particular countries and by progress in our understanding of the obstacles to development. Many leaders in less-developed countries are now expressing strong interest in market-oriented policies, but understanding of the implications of such policies is still lacking in many quarters, and reformers face the determined opposition of entrenched interests that benefit from inefficiency-promoting policies. Where donors may be able to be particularly helpful is in aiding reformers to expose to public awareness the real consequences of existing policies and arrangements.

There is much that we do not know about why reforms take place, and we should recognize that it is not straightforward to promote them. We should expect many failures along with the successes. The problems are in a fundamental sense political and thus beyond the control of donors. But given the nature of politics, and in particular the incentives of political actors to conceal their motives and the consequences of their policies, there would seem to be much to be gained by training specialists who can understand the implications of different economic and social institutions and by helping them to disseminate broadly the consequences of particular policies.

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Who Gains From Policies That Increase Poverty?[1]

Mancur Olson

One of the reasons for poverty in the Third World, as in our own country and the rest of the First World, is bad luck. And this bad luck can take many forms, even the form of bad luck in, as it were, the lottery at birth. One person may be born as strong as a fullback, another may be a quadriplegic. So the differences in health, ability, and fortune of many kinds explain a lot of poverty in the Third World, as well as elsewhere. But I would argue that a fair amount of the poverty in the Third World is not due to luck and is not an accident. It is the side effect of policies and arrangements that are chosen by well-placed individuals, and well-off groups, in their own interests, that have the side effect of greatly increasing poverty. This aspect of the poverty of the poorest groups in the Third World, and in the Second World, is important for what the policy of USAID and the US government should be, and important also for research.

Well-placed, well-off groups in many Third World countries distort policies in their interests in ways that increase inequality. These well-placed people may be individuals who act individually, and they may be groups that act collectively. I would first like to look at individual action as opposed to collective action to generate arrangements that are good for the person who takes the action but bad for the poor.

I would first like to make a very simple and obvious point: that on average the opportunities for corruption and the size of the gain that an individual may make by doing something corrupt rise with rank. Of course there may be corrupt acts by the humblest people in the government, and they may have transactions that are corrupt with poor individuals, but when you think of the quantitative aspects of the matter, when you think of the size of the bribes and the payoffs and the size of the favors or exemptions granted, then surely on average it must be the case that the higher the rank the bigger the bucks involved in corrupt action. And that's not only true for the government officials themselves; on average it seems to me to be true of those who gain from paying bribes to get various official monopoly favors and so on. By and large the poor person from the remote area of a Third World country will not have the connections and the access to the high-ranking official who might take the big bribe and who for the big bribe might give some big benefits. By and large it's the people in the higher social and economic circles that will have access to the higher levels of officialdom where the bigger bucks are at stake.

Even if everyone would agree to that point, that on average the people at the top will be involved in bigger forms of corruption than anyone at the bottom, many might argue there probably isn't that much money at stake. Maybe the total amount that's passed in bribes and so on is small, even in a relationship to the national income of a poor country. But it doesn't follow at all that the implications for poverty are of small quantitative extent.

Let's think for a moment about the way that high officials might increase their gains by corruption. Suppose that something is happening in the market and it's working out fine for buyers and sellers. The buyers and sellers are getting together and making a mutually advantageous trade; they're not going to need to pay any bribes for that, as long as the rules allow them to make whatever transaction they find mutually advantageous.

[1] *Draft transcript. Do not cite or quote without permission of the author.*

But now suppose that the price is fixed lower than the price in the market. or above the price that the market would carry. Or suppose the quantity is smaller or larger than the quantity that would be traded in the market. In any one of these four cases, both the buyer and the seller will profit if they can get away with paying a hrihe to an official that permits them to engage in a mutually advantageous transaction that this official or others has made illegal. In other words, one of the ways to increase the return for corruption at the higher levels is to make illegal all sorts of types of transactions that are advantageous for the parties involved or to require permission or licenses, thereby opening up a bribe possibility. This is also true with production itself. If you make some profitable type of production require permission or a license, that opens up yet another opportunity for bribery.

Now, my argument is that the quantitative significance of these actions taken by highly-placed people to increase their corrupt gains can have large quantitative consequences, particularly for the poor who will be disproportionately, in most cases, the victims.

So, that seems to me a very systematic and tragic source that augments poverty at the same time it holds up economic growth, and if we're not aware of this incentive, we'll do much less well by the poor than otherwise.

In addition to individual action of well-placed people that increases poverty, there is also collective action of well-placed groups that I hypothesize increases inequality as well, especially in the Second and Third Worlds. The reason is, I believe, that the capacity for collective action is disproportionately available to groups that are better off than average, and at least disproportionately available to the non-poor as against the poor. And it is disproportionately available to those who are well established and to people from the capitals and other big cities of the Third World, and least available to people in the remote rural areas.

Let's first look at the way in which numbers affect the capacity for collective action. Suppose that in some line of commerce or industry there is a small number of firms of significant size: Say that three big families control some line of commerce or industry. Well, each of these families, if they have enterprises of the same size, will get about a third of the benefit of any action each of the families takes in the interest of the line of commerce or industry in which these three firms or families are located. If they can get a higher price, a firm that sells a third of the product will get about a third of the benefit of the higher price. If there is any kind of subsidy or protection, it will tend to be shared by a small number of firms and that will be true in any situation in which collective action is required. When there are small numbers, each family or firm can say to each of the others, "I'll cooperate if you do, but not if you don't," thereby increasing the incentive for the others to cooperate, and this can lead to a joint maximum or group-optimal level of collective action.

So, we know then that the groups that are first to engage in collective action in the Third World -- and in the First World too, historically -- are small groups of relatively large firms or families or managers in particular lines of commerce or industry. This observation is not something new with me. Adam Smith, in *The Wealth of Nations*, was concerned about mercantilism because he saw that collective action in the 18th century was by mainly merchants and manufacturers, and that is why his book was an attack on mercantilism or on a society influenced by the lobbying and price-fixing of merchants and manufacturers.

Such evidence and observations in which I've been able to engage makes me rather confident that small groups in particular industries are the most likely to be organized for collective action in the typical country, and most especially in the typical Third World country. Now these groups will then have incentives to get favorable regulations and protections advantageous to them, but often disadvantageous to the society at large. They will often have incentives to get the gains from monopoly -- that is to say, to sell less and to charge more. The mass of the people in the rural areas will, of course, not be able to act collectively because of the disadvantage of large numbers. In general, if you have a large number of consumers, a large number of poor, a large number of peasants in an underdeveloped country, if any one of these people acts in the interest of all other peasants, or all other consumers or whatever, that person will get only a minuscule share of the benefits to the class, but that individual will bear all the costs of any action to support the group. So whereas in the small group where each firm or family gets a large share of the benefit of collective action, in a large group like the peasantry or consumers each individual will get a minuscule share, but still bears the whole cost of whatever he or she does, so there isn't collective action in large groups.

Now there is one exception to that. And that is when large groups can be organized for collective action because it's possible to overcome this free-rider problem that arises because the benefits of collective action go to everyone in some group or category. This exception comes when it is possible to apply some punishment or reward to the individuals/in a large group, according as each of these individuals does or does not support the collective action by paying dues or standing in picket lines or whatever.

Let's suppose there's a large establishment -- a big government office, or a factory, with one or a few entrances. Well, a small number of men with muscle may be able to work out a picket line which makes adherence to collective action rational for each of the individuals involved, even though it wouldn't have been in the absence of this selective incentive.

I've shown in a book on *The* Logic *of* Collective *Action,* and it has been corroborated in the large literature that's been developed since then, that large groups never engage in collective action over extended periods of time without some kind of selective incentive or individualized punishment or reward that overcomes this free-rider problem.

Now let's ask the question what large groups in a Third World country, or in a formerly Communist country will have the capacity for collective action?

Well, certainly not groups such as the unemployed. The unemployed are scattered all over, and there isn't any one door through which they need go and no one place where a picket line would work. Similarly, you couldn't imagine a consumers' cartel or organization working through picket lines. The only large groups that can organize for collective action are those that are concentrated, as the employees in a large firm or a large government office. So those would be in a situation where the high transportation and communication costs of a Third World/country wouldn't keep them from getting together.

So it's the established workers, and usually established workers who are not at the bottom of a pay scale, who will be most likely to form a labor cartel or an organization of any sort for collective action.

In the Third World, as we know, transportation and communication are bad, and literacy on the whole is low, and so the peasantry in a Third World country will almost never be able to organize for collective action. In addition to not being in any one place, they haven't got the transportation and communication resources to form big farm organizations. So I hypothesize, then, that it is particularly groups in the big cities and especially in the capital cities, groups close to the government, that will be able to engage in collective action. These will be disproportionately the relatively larger firms in particular lines of commerce, and the workers in the big cities and in the towns. So then, I hypothesize that collective action, both by small groups and by large ones, will in most cases have an inegalitarian effect. Generally speaking, the poorest people in the Third World country will be the people out in the rural areas, or the unemployed, and these will be people who will not be able to engage in collective action. By contrast, the firms that seek, let's say, import-substitution policies for protection will often be able to engage in such action, so also will the workers in somc of thcir factories and enterprises. People in the capital cities. close to the government, may be able to work out a demonstration that has some effect, but by and large the poor people outside the capital cities will not. In the same way that individual action favored those of highest rank, so it seems to me to a less striking but still definite extent, collective action also will tend to have an inegalitarian effect. It will tend to introduce various types of protection. regulation, and subsidy, which can work against the poor and against an efficient and innovative economy.

Why am I assuming that this would be harmful to the economy in a major way and harmful to the poor? Well, let's look at the incentives facing each well-placed individual who uses corruption to make himself better off, and each small group or large group with selective incentives that uses collective action to make that group better off. What are the incentives each of these individuals, each of these groups, faces?

Well, generally, each of these groups will be small in relationship to the whole economy, even if the firms are fairly large in some industries. If they are large firms in a single industry, those firms will still, in general, be a small part of a whole economy. Even if there's a large group of workers in some factory, they will be a small part of the total population and the total economy. This means that they will bear only a small part of the losses that come from any inefficiencies that they introduce into the society, even as they gain the whole amount of the redistribution to themselves.

If, for example, there's a system of regulation that generates more bribes, or that keeps out domestic or foreign competitors, then it greatly reduces innovation, the inflow of foreign capital, and economic progress. It doesn't follow that because the losses from it are large, that those who propose the regulation will not gain from it, because if they represent one percent of the income-earning capacity of a country, that country's income can fall by a hundred dollars for every dollar they gain in distributional struggle and they will not lose from it. In other words, it pays each small group to press whatever kind of corruption, distortion, or regulation to an extent to which the social losses can be very large in relationship to the amount of individual gains. Large inefficiencies in the interest of some individuals and groups, which not only hold up economic progress generally, are particularly adverse in their effect on poverty because the poor are almost never well-placed and almost never have the capacity for collective action. I know of no country in all the world where the poor are organized for collective action. So, that's another reason why I believe this is quantitatively important.

Now you may say, well, how could we test Mancur Olson's argument? Is the story Mancur Olson is telling one that generates testable implications that we can compare with the reality? And so I would like to toss out a couple of testable implications of the argument I've put forth, a couple of things that should be true about the world if what has been said so far is true, but not true of the world if it's false.

In the Third World, with the difficulties ot transportation and communication that are so serious in the rural areas, with the special advantage of interests in the capital city, and so on, if what I have said is true, we should get the result that agricultural staples would normally be priced far below the world price. The theory also predicts that this will not be true of the advanced countries with good transportation and communication, with long periods of stability in which even the farmers are organized for collective action. And that implication fits the facts in spades. As Hayami, the Japanese agricultural economist, and Kym Anderson, an Australian agricultural economist, have shown, systematically, and often to a striking extent, the Third World countries are countries that price agricultural products for their own growers, their own peasantry, way below the world price. Of course developed countries, and most especially those that do not have comparative advantage in agriculture, such as Japan and Switzerland, tend greatly to overprice agricultural products.

Now, note that the numbers would lead to exactly the opposite prediction. If it is forces of numbers, through voting or muscle or social pressure, that explains policies in the Third World, then farmers should be relatively most important. These countries are where farmers are relatively most numerous. It's in the deep past of the West, when the farmers were relatively more important to the economy that they should have got the most favors, not more recently.

So it's clear that the prices of agricultural staples in general fit my argument. I have a student, Thierry van Bastelaer, who is doing a thesis on this now and the quantitative evidence he's finding is strong.

A second testable implication of my argument is that if I'm right in saying that by and large the capacity to get favors out of government is something that is in the higher reaches of the social order more than it is in the lower reaches, then we ought to expect that disproportionately it would be the high-ranking people that would be part of the open, legal, governmental system and the poor people who would be outsiders, That is to say, my argument predicts that the net gain from going outside of the system would be greatest to poor people. And, of course, we see that the informal sectors in the Second and Third World are disproportionately made up of the poor, and that is again consistent with the argument put forth.

Now then, the question arises: What would be the implications of this argument, if true, for what USAID policy ought to be? Well, it has many implications, but one of them that seems to me probably not so controversial is the implication that if you directly help poor people by giving them some resources, and there is no change in the country's institutions or policies, climate of opinion, attitudes of the intelligentsia, or political outcomes, what help you give the poor will help them only as long as you're giving them help and only to the extent that you're giving it. If the system is stacked against poor people, and it' it has, m addition, various systematic inefficiencies that reduce the rate of innovation and the efficiency of resource allocation, then the poor are not helped decisively and in the long run by giving a little bit of resources if they continue to operate in a system that is stacked against them. Of course individual persons may leave the category of the poor and become members of the more fortunate categories, but in general one is not going to solve the problem of poverty just by giving resources or help to poor people in an environment in which there is no improvement in policy or institutions. In any event, the money of the aid-givers is far too little to do that much to help to solve poverty across the hundreds of millions of people in the Third World.

Another implication of the argument is that by persuading the leaders of a country -- if even by conditionality of a kind that multilaterals can do -- to improve institutions and policies, there can be large gains. The institutions and policies in the poor countries are institutions and policies that not only have failed, but in addition to a disproportionate extent serve interests other than the interests of the masses of the people in those countries. Experience tells us that in a low-income country that adopts good policies and institutions, standards of living can easily double in a decade, and then double again in the decade after that, and double again in the decade after that, increasing eight-fold over 30 years. Really big advances in elimination of poverty, not to mention better standards of living for these who are not abjectly poor, are possible through better institutions and policies. However, these better institutions and policies, of course, won't be easily attained because there are interests that have a stake in the policies that arc good for groups or individuals but bad for the country as a whole.

I would argue that economic development requires, as it were, helping a country with an understanding of its problems; helping a country get a better understanding of economics and politics, a better understanding of an integrated view of economics and other social sciences. This better understanding of that is not something that, on the whole, the multilateral organizations can do, and it needs more to be done by individual aid-giving governments. Countries like the United States that have a history and a policy of promoting goals like democracy and free markets abroad would be better able to do the kind of thing that

I think is most important for poverty reduction than would the model multilateral organization.

I haven't had the time to put forth the qualifications that are so greatly needed, I believe that we won't deal adequately with poverty in the Third or Second World unless we first understand and wrestle with the fact that some of this poverty is no accident.

QUESTION AND ANSWER PERIOD

Q: On the question of which countries have done the best, you've used a couple of kinds of indicator, such as per capita consumption. We all use the World Bank numbers for both social and economic indicators. I wonder if you could comment on how accurate you think the numbers are on, say, infant mortality, primary school enrollment, or per capita income itself7 Are these accurate measures so that we can really say that the countries that appear at the top of our list are the countries that ought to be there because what we are measuring is really an accurate representation of the underlying reality?

Clague: I don't have an innovative answer to that question, but I don't doubt that there has been a dramatic decline in poverty in the countries in the World Bank's table. I think the numbers are sufficiently accurate for that. Of course figures such as income are all subject to the limitations of the national accounts of the countries themselves, but I think there have been considerable improvements in the way that they are collected, and I think we have a much better handle on them. In cases where results are dramatic -- the minimal reduction in underage mortality in the ten countries I talked about was 73% -- I think we can be fairly confident that all those countries had a considerable decline in that particular figure. And I might mention, Drèze and Sen, who have studied these figures carefully, have reported that these are countries that have genuine improvement In the well-being of the poor.

Q: You describe the two tables of the countries that have achieved reductions in infant mortality and improvements in other indicators. And then the other result from Drèze and Sen was that most of the reduction in poverty head count was attributable to growth, not redistribution. To me that seems something like a paradox, do you view it as such, and how do you reconcile this? Could it be that the statistics that measure poverty or income are not a very good indicator of welfare?

Clague: Well, I think they are somewhat in contention with one another. I think the simple explanation is that the well-being of the poor is multidimensional. People are better off if their children don't die. They're not necessarily richer if their children don't die. Income is not a sufficient statistic to capture the well-being of the poor. The income of the poor doesn't include the quality and availability of the local school. It doesn't include whether immunization programs are available that reduces infant and child mortality. There is a connection, but not a terribly tight connection, between the income level of a family and the degree of malnutrition. So, all I can say to that is that poverty is multidimensional and we need to consider various measures of it. There is one unifying element, though, and that is -- it may be a retreat to a slightly abstract level -- that in order to reduce poverty we have to have better institutions. Institutions for delivering public services are institutions that enable the economy to innovate and grow.

Q: Would either or both of you care to comment on the impact the rise of access by some of these developing countries to the international capital markets in terms of the ability of local large firms to hold down a monopoly position in these countries ? Do you think that the capital market access or integration raises or lowers the opportunity for poor people in these economies based on your notion of collection action?

Olson: Well, I haven't checked the numbers myself but I gather these international capital flows are now so large that on a typical business day in the United States a trillion dollars gross crosses our borders -- a really gigantic amount of capital flows from country to country, mainly, of course, to and from countries like Japan, the United States, and the nations of Western Europe. Now, what would be the implications here. The first implication that occurs to me would be that such capital mobility offers tremendous opportunities for poor country with little capital. If that country gets its arrangements right, gets its policies and institutions right so that capital will operate under the same policies and institutional conditions in that country as in the richest countries of the world, then the capital will have extraordinary returns. If countries get their arrangements right, they can benefit from capital flows so gigantic that aid budgets are trivial, by comparison. So one implication of the argument, then, is that the international capital markets mean a tremendous opportunity for poor countries that get things right. The paradox is that we often have capital flight from capital poor countries in Latin America or Africa or parts of Asia to rich countries like Switzerland and the United States, and that paradox, it seems to me, is explicable only in terms of the adequacy of the institutions and policies in those countries that are poor and not growing as fast.

Now let's suppose you take a country like France in the 1980s. France was engaged in expansive fiscal and monetary policies at a time when most others industrialized countries were in recession. The French government didn't want to withdraw from the Common Market and interaction with the Western world, and it also couldn't maintain its policies because of outflows of capital. Capital controls were put on for a time, but there was just so much exposure of the French economy to the outer world that they couldn't maintain a set of policies that they once had because international capital flows. They could only have stopped these flows by withdrawing -- by changing the nature of the country and getting out of the Common Market and so on. I think a country like France can be greatly limited by international capital flows. But now suppose you take a country like Zaire. Suppose you take a Third World country that has bad arrangements and institutions and high levels of protection and capital control. Capital controls may not succeed in keeping capital from leaving particular countries, but to the extent these countries are relatively self-contained, and to the extent they're not part of institutions like the Common Market, they tend to persevere in counterproductive policies not withstanding the capital markets. To consider the example of the formerly Communist countries, especially many of the countries of the former Soviet Union, suppose there are corrupt officials who can violate any contract, who can call into question any property right. Certainly they can seize on capital that flows into the country, and not only can they do that, this has sometimes in fact been done. So, alas, I would conclude that the poorest countries, least integrated into the world economy, can persevere in bad policies not withstanding international mobility of capital.

Q: Could I follow up on that? What policies would you suggest for donor nations to change the policies of a country like Russia that has cormpt officials and bad institutions to bring them around?

Clague: That is the perfect introduction to our next speaker. Economists are always good at telling you what the problem is, but sometimes we have an exceptional economist that can offer constructive suggestions for improving matters. And so our next speaker is Robert Klitgaard, who has written most interestingly about the problem of corruption, as well as the problem of choosing relief and economic policies in poor countries, and his topic is "unintended consequences."

Unanticipated Consequences[1]

Robert Klitgaard[2]

Many anti-poverty programs have unanticipated consequences. Sometimes unforeseen results are favorable, displaying what scientists call *serendipity* or what Albert 0. Hirschman once called "the Principle of the Hiding Hand"--more on that in a,moment. But the unanticipated consequences we tend to hear more about are the unfavorable ones. A classic example is Daniel Patrick Moynihan's study of the doctrine of "maximum feasible participation" in community action programs in the U.S. War on Poverty. He called his book *Maximum Feasible Misunderstanding.* Even community participation, that most sacred of cows, can lead to unforeseen negative results.

Why do our well-intentioned efforts to reduce poverty often go awry? In today's talk I will take a stab at providing a typology of "unanticipated consequences." The most important of the categories, I believe, concerns information and incentives, and how these affect the institutions through which our anti-poverty efforts are implemented. And this leads to a prescription: our programs to reduce poverty require "institutional adjustment," including the systematic improvement of information about outcomes and the linking of incentives to them.

On occasions like this the temptation to theorize abstractly is great. To counteract it, and to contextualize our discussion, let's begin with four examples of unanticipated consequences in development work.

India 1970

Put yourself in India in 1970. Milk consumption per capita has dropped from 139 grams in 1950 to 126g in 1960, then to 105g in 1970. The quality of milk, in terms of butterfat content and non-fat solids, has also been falling. Simultaneously, people have been bringing cattle into the cities like Bombay, becoming in effect urban milk farmers, despite obvious economic and environmental disadvantages. India's milk policies seem liberal enough. There is a free market for milk, with no price controls. Moreover, the European Economic Community is providing powdered milk and butter as foreign aid. But the situation is a mess. What would you do about that?

Indonesia 1985

Consider a second example, rural banking in Indonesia, 1985. The government has decided to follow a market-driven interest rate, consistent with the advice that USAID gave back in the early 1970s when the Administrator's Annual Review, in 12 volumes, argued against subsidizing rural interest rates. Indonesians have raised the interest rate to 30 percent. But nothing is happening in the Indonesian People's Bank. Poor people still aren't getting loans. The Bank is still not collecting on the loans it does make, and many branches are losing money. What would you do about that?

[1] Edited transcript from IRIS miniconference on "The Paradoxes of Poverty," U.S. Department of State, Washington, D.C., May 27, 1994.

[2] Professor of Economics, University of Natal, Durban.

Bolivia 1986

The third example is the Bolivian social emergency fund, 1986. In 1985 Bolivia launched one of the most aggressive free market adjustment programs in the hemisphere, with radical stabilization and liberalization at the same time. Various donors and the government, worried about the constricting and destabilizing effects of these changes, decided to initiate a Social Emergency Fund to fund public works based on applications from local communities. A key goal was massive job creation at the minimum wage. The Bolivian President gave the new SEF a very high priority, and the SEF director reported directly to the President, Money was not lacking. Yet after one year nothing has happened, except that some forms on how to submit requests for projects have been designed. What would you do about that?

The Gambia, 1994.

The Gambia is a tiny country, "the hot dog inside Senegal." In 1985 The Gambia declared a free-market economic policy. It is a democratic country. On both economic and political grounds, the country seems to have its "macro" policies right. And yet, since 1985 the per capita income has risen by 0.6 percent a year compared to 1.4 percent per year before its economic adjustment. This is the worst record of any of the six countries named by the World Bank in 1994 as the "six best adjusting countries in Africa." In The Gambia, investment has dropped. Agricultural production hns fallen. Health and education spending have been reduced. Overall, The Gambia's economic performance is miserable despite the free market policies and democracy. What would you do about that?

Each of these cases displays "unanticipated consequences." In each case, policy changes have been made in the direction most economists and aid officials would favor. In India there was a free market for milk. In Indonesia the interest charged on rural loans was determined by -market forces, not government subsidies. In Bolivia the Social Emergency Fund built on bottom-up initiatives, enjoyed political commitment, and had plenty of money. In The Gambia free-market economic policies have complemented a multi party democracy. Nonetheless, in each case things weren't working out quite as well as people hoped. Why not?

Some people might say that the policies described were and are misguided. For example, having free markets for milk is not a good idea, and a market interest rate for poor people, as in the Indonesian case, is a mistake. As for Bolivian social emergency fund, the government should not wait for applications from communities. We know what they need: They need roads, they need clinics, they need schools. Let's build them. This is an emergency. And in the Gambian case, many people in that country, and many people around Africa, are questioning whether adjustment works, even whether democracy is as beneficial as advertised.

Others disagree. The policies are "right," it is their implementation that must be going awry. We should look at the institutions through which they are being implemented. They lack information, and they incorporate adverse incentives. To illustrate this generalization, let's take a look at what in the first three cases they actually did to make things work.

India's Operation Flood

In India, market prices were liberalized but market institutions needed reform. The EEC thought it was helping out by donating massive amounts of powdered milk, but of course this tended to lower the price of milk and affect the incentives of rural farmers adversely. As prices fell, transportation of milk to the urban markets made up an increasing percentage of the costs, so people started bringing cows into the cities, leading to wasteful and unhealthy urban cattle colonies. And there was a kind of adverse selection phenomenon. People were paid one price for milk, regardless of its quality. So if you happened to dump a gallon of water into your milk can, you would be paid the same price as another chap who had a high butterfat content and high levels of non-fat solids.

This story has a happy ending. The successful Indian response to this crisis. Operation Flood, has been analyzed from many perspectives. The home of Operation Flood in Anand is a Mecca for cooperative lovers from all over the world, who peregrinate there see a coop that works. A crucial element to Operation Flood's success pertains to information and incentives. Through the improvement of market institutions it overcame the phenomenon of adverse selection.

Key innovations included the development of a simple apparatus to measure the fat content in the milk, and institutional reforms to make sure at the village level that milk was collected twice a day, that farmers were paid promptly for the milk according to the butterfat and nonfat solids content of the milk. Importantly, the people doing the grading were right there in the village, and included locals whom you knew and trusted. Immediately the incentives to "cut" milk with water were eliminated.

These steps were complemented by efforts to raise quality through such things as better animal husbandry techniques and improved transportation and through the use of brand names. Within ten years, milk production rose tremendously. Farmers who participated in this program were paid 15 percent more for their milk and yet Operation Flood was able to sell its milk at a 9 percent lower retail price. Studies estimate that villages participating in Operation Flood did about 17 percent better than similar villages in India. It has also been estimated that within nine years one million families doubled their incomes from this program. I find this last statistic a little bit difficult to believe, but there is little doubt that Operation Flood was a great success.

Indonesian People's Bank

What about the Indonesian People's Bank? In 1984 there was a market interest rate combined with a lot of exhortation of bank officials to help the poor. And nothing was happening. Then somebody decided to reexamine incentives and information at the local level. What were the actual incentives for bank officials to do what they should be doing?

From this question arose the KUPEDES program. First, information was developed at the local level which accurately reflected the savings generated from each village unit, the repayment rates, and who was getting the loans. Second, authority was decentralized to local bank managers so they could make decisions and respond to local conditions. Third, and crucially, local bank staff was paid depending on their results in getting loans to the poor, ensuring their repayment, and generating savings at local levels.

The KUPEDES program lost money in the first year, but already after three years 82 percent of the village units were making money. The rural banking system tripled its loan volume in three years. By 1990 it was the second biggest rural credit program in the world. There are still some problems with insufficient numbers of very small loans, probably related to informational and transactions cost problems well-known from other countries. Maybe Indonesia will see some institutional solutions here as well, for example by using poor people to help screen themselves through co-guarantee programs, or pooling loans to several poor recipients and other mechanisms to reduce the transaction cost per rupiah loaned. But the Indonesian People's Bank is a success story.

Turning Around the SEF

What about the Bolivian Social Emergency Fund in 1986? Recall that after one year nothing had happened. Enter a businessman named Fernando Romero, who said, "Lct's try somcthing diffcrcnt." Using his high-level political support, he said in effect, "Mr. President, I would like to go outside the civil service to hire people and match private sector base salaries. The SEF will have a mystique of serving the poor, but I'm going to add to that a chance to be promoted quickly depending on your results." What results? Results in terms of building projects that poor people request at reasonable cost, and generating jobs.

The SEF set up a process that asked the communities, working with the private sector constructors of schools, roads, sewers and so forth, to submit proposals that were vetted centrally through a comparison process. In a second round some technical assistance was given to the weaker communities that did less well in preparing projects.

Information and incentives again were crucial. The centralized information process included estimates of costs of per unit of things like rural roads and schools, so that when proposals came in with outrageous amounts officials had some way of telling that. The process included incentives for the people in the bureaucracy to actually visit rural areas. Bolivia is a country twice the size of France that had 1100 kilometers of paved roads. So, like many other developing countries, it is not a place where most bureaucrats like to leave the capital. Incentives were built into the program this so they would do so.

As a result, suddenly things started happening. After two and a half years the SEF moved millions of dollars and created thousands of jobs. And it did so efficiently. Despite salaries considerably in excess of government norms and despite aggressive systems of promotions and incentives, the SEF's administrative cost per dollar moved to rural areas was less than 4 percent. This compared favorably with the amount that USAID would pay the UNDP to administer a project in Bolivia, which was 7 percent. Now, I'm not saying UNDP is a paragon of efficiency, but it is not the usual Bolivian agency that will out-perform an international institution.

One unintended consequence of this program was highly favorable. As an effective program of decentralization it empowered communities, not only through communities' saying what they wanted, but through their helping to build what they wanted. Decentralization worked because centralization worked--a paradox that nonetheless is a successful generalization. The SEF centralized the appropriate things: information, negotiations with international donors, and incentive systems for SEF employees. This in turn enabled it to decentralize the design and construction of rural projects.'

Analytical Paradigms for Improving Institutions

These three cases each exhibit "unanticipated consequences" that were successfully addressed. Do these cases have anything else in common? Do they contain lessons for The Gambia, the fourth case I described? I think the answers are yes and yes. And at the risk of hyperbole, I believe that what these cases have something in common may be described as one of the development challenges for our decade: *institutional reform.*

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[3] These cases are discussed in my book *Adjusting to Keality: Beyond "State vs. Market" in Economic Development* (San Francis& ICS Press and International Center for Economic Growth, 1991), with references.

A key development challenge in the 1980s was getting the macro institutions of society right--a challenge, of course, that never subsides. Macropolitical reform means multi-party democracies and basic rights for people. Macroeconomic reform means restoring stability to international and domestic balances and liberalizing markets in the sense of letting prices be determined more by private forces than by government decrees.

We have learned a lot from those important reforms, which amounted in many parts of the world to revolutionary transformations. Among the lessons are some "unintended consequences." Democratic reforms do not necessarily help the disadvantaged unless democratic institutions are improved--party systems, legislatures, mechanisms for popular participation, the administration of justice, and (my emphasis today) bureaucracies stimulated by incentives linked with accountable measures of performance. And macroeconomic reforms do not necessarily help the poor unless market *institutions* are improved--better systems of quality measurement and standards, property rights, contract law, and so forth. And so today's challenges go beyond "macropolicy" reforms to the improvement of the institutions of both state and market.

Let us begin with **improvements to market institutions.** Markets where information is imperfect and asymmetrically held will often be biased against the poor, for whom and with whom credible information may be scarcer and more difficult to process and certify. In markets where institutional frameworks are poorly developed in the sense of legal systems, it is difficult to make credible commitments such as contracts or to get loans repaid, and therefore these markets will systematically under-perform. In such circumstances the rich have many advantages--information for them and about them may be less of a problem, and they may have their own credible ways of making commitments or enforcing compliance. Poor people have fewer recourses. They will use traditional mechanisms to assess quality, such as repeated and interlinked transactions with well-known neighbors, or traditional ways of guaranteeing compliance, such as working within the clan or tribe. These traditional mechanisms are in some sense constrained Pareto-efficient, given their situations. But these institutions are not as efficient as modem economic institutions such as open markets, formal banks, formal insurance, and legal compliance. Indeed, part of economic development involves the replacement (or supplementing) of traditional solutions to problems of moral hazard, adverse selection, contract problems, enforcement problems, and su forth, with modern institutions fur cluing those things.

I approach the improvement of market institutions with the following paradigm Quality varies, say among workers or credit risks or milk lots. Second, information about quality is imperfect and asymmetric. Third, incentives to cheat, mislead, and renege exist in the marketplace. These three conditions generate a host of problems for markets, to which traditional and modern economic institutions arc in various ways "responses." I have tried to lay out a framework for analyzing alternative policies for improving market institutions in my book *Adjusting to Reality.*

It is important to observe that the improvement of markets often depends on well-functioning "non-market institutions," especially governments. For market institutions to work better, government institutions must work better. Beyond "market vs. state" we encounter "market and state," indeed "market because of state."

So in the 1990s and beyond, we have another pressing item on our **agenda--improving government institutions.** It is not that this challenge is new, only that in the wake of the macro reforms of the last decade we are newly aware of its centrality. The problems faced by the Indonesian People's Bank and the Bolivian Social Emergency Fund are generic. How might we think about institutional reform in the public sector?

Fortunately, recent work in economics offers analytical paradigms that can help guide us through this terrain. Models of horizontal and vertical integration in the industrial organization literature provide useful analogies to issues of decentralization and to the integration of public service in rural development and other areas. The principal-agent model and the new theory of the firm help us to rethink what mechanisms there are for getting public employees themselves to work more efficiently and less corruptly.

Today I would like to underscore a key feature of institutional reform, the transformation of public sector incentives. Let us return to the case of The Gambia, where unhappily there is no success story yet.[4] There are serious incentive problems in The Gambia, where real wages in government are estimated to have fallen 40 percent since the late 1980s. And there are few links between pay and performance, so that those who don't leave government face tremendous temptations to get away with moonlighting and corruption. The fact is that in many developing countries, one has to be pretty stupid to work for the government if one is making anything on the side.

The Gambia illustrates a chronic problem--and, alas, a widespread and in my opinion incorrect approach to institutional reform. Aid agencies are in important ways culpable. This approach features a lot of technical assistance personnel with white skins and state-of-the-art Mitsubishi jeeps doing multi-year studies of various pieces of the bureaucracy. Connoisseurs of irony will appreciate that these foreign experts are free from civil service pay constraints--indeed, they are typically paid ten times as much as, say, the Minister of Finance. This approach to civil service reform is persuaded that bureaucratic reform must above all obey the principle of horizontal equity. There is also what might be called the Albanian approach to planning (or former Albanian approach), in which civil service reform must proceed from a huge, across-the-board blueprint. Better incentives ? Well, the hope is that after the reform we'll be able cut back the public sector and use the money left over to raise everybody's pay by, say, 8 percent.

But such a small and distant change will not solve the incentives crisis. We need quite a different approach. I believe we must jettison the constraint of horizontal equity and the goal of across-the-board pay increases, and begin instead in a few key agencies and with incentive *experiments.* For example, begin where experiments with incentive reforms might pay for themselves: raising revenue, or saving costs in public works and public enterprises, and perhaps some strategic areas where the effects on corruption could be large. Instead of the seemingly endless studies done by foreigners and the goal of an Albanian-style plan, begin with experiments designed by locals, indeed/with the participation of the very public officials affected by them. Use a transparent medium-term evaluation to calm fears that civil servants will be the victims of reform.

The book *Paying for Productivity,* edited by Alan Blinder, tries to pull together lessons from incentive reforms around the world, particularly in the private sector. A rule of thumb emerges. Productivity bonuses should be of the order of 25 percent of the salary, not 5 percent or 200 percent, and such bonuses typically yield performance increases of 25-30 percent.

But where will the bonuses come from? Many poor countries are broke; certainly, not every civil servant can be offered a 25 percent performance bonus immediately. The approach I'm recommending begins with experiments, trying to learn something from revenue-raising agencies and cost-reducing agencies. The experiments generate more revenue, and thus are able to finance incentive reforms there and new experiments elsewhere. One begins by asking people in the ministries to design the experiments themselves. Try to get them to give some sort of quantitative summary of what they think the existing problems are. Ask them to think about the measures of success in their organizations. How would they measure something to show that

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4 In July 1994 The Gambia experienced a coup d'etat, which was excused by the new regime as necessary to combat corruption.

they're doing a good job? Ask them to make a proposition to their own government: "If we have the following resources and incentives, we will within k months attain the following measurable objectives. And if we don't we will not get those incentives." In other words, help them design pay-performance experiments in which they only get paid if they can achieve a target.

A Partial Classification of "Unanticipated Consequences"

Let us now consider how the phenomena we have been considering fit into a more general view of unanticipated consequences. The first point to note, I believe, is that most consequences in anti-poverty programs are in fact as expected. Houses get built, jobs get created, inoculations are provided, and much food aid does get to the hungry. It is common for pundits to render it differently, as if every time the government or a relief agency tries to do anything, it always screws up, that everything is an unintended consequence. But actually most of the time consequences are intended, and they turn out pretty much what you thought they were going to be.

A second prefatory observation: Unanticipated consequences in anti-poverty programs are not always negative. In policy circles we have become perhaps too accustomed to think that all unintended results must be bad; in science, we are much more tolerant, and indeed we are fond of thinking about serendipity, good things that happen as the unintended outcomes of trying our hardest. Albert 0. Hirschman noted this pessimism in his book ***Development Projects Observed,*** and he begged to differ. He hypothesized that if the problems encountered by most development projects had somehow been anticipated, the projects would never have been undertaken in the first place. ,But his emphasis was on a second point. In the projects he studied, the problems encountered were usually overcome. Projects were usually successful, despite unanticipated problems, because of unanticipated creativity and adaptation. This Hirschman dubbed "the Principle of the Hiding Hand." A kind of henevnlent ignorance protects us from scuttling potentially successful projects, because even though problems do occur, so do unanticipated, creative solutions to them.

This suggests a question that to my knowledge Hirschman never raised. Under what conditions in an anti-poverty program will unintended consequences tend to be good rather than bad? When will the Hiding Hand tend to safeguard success rather than permit failure? My answer: when the institutions implementing those projects have abundant information and appropriate incentives.

Let us consider several categories of unintended bad consequences, hardly exhaustive but leading up to my point. Using the idea of USAID's logical framework, let us posit that the anti-poverty effort is based on a series of if-then statements. "If input X is provided, output Y and utilization Z will follow, leading to social benefit." Why might consequences turn out not to be those we anticipate?

1. Wrong theory, wrong model. We hypothesize that treatment A will help patient B, but in fact it does not, or has side effects. In many areas of anti-poverty work, our ignorance is compounded by our ideologies or lack of ideologies, leading us to posit "log frames" that are simply mistaken.

2. Statistical phenomena.

(a) Bad luck. In other words,' the if-then statements are only probabilistically true, meaning that sometimes there will be unanticipated results. Success and failure are influenced by random factors, Sometimes bad things happen.

(b) Treating a heterogeneous population as homogeneous. The if-then statements are true only for a subset of the population. One example are poverty programs or poverty targeting that treats all poor people as if they had the same strategies for escaping poverty, or even the identical definitions of "escaping poverty." The result is what medical researchers call a treatment-by-patient mismatch. A second example are programs that do not recall that within the category "poor" are distributions of such attributes as motivation, preparation, ability, and health. Thus, if programs have incentives for self-selection or selection by those implementing the programs, the "unanticipated consequence" of creaming ensues.

(c) The normal distribution of readiness. The if-then statements are more true for some people than others (more intense, higher elasticities4 etc.) Because the category of interest (such as "the poor") in fact involves a distribution of readiness to respond to the program, virtually any innovation that improves the average will also tend to increase inequality in the short run. For example, the people most ready to take advantage of family planning or a new agricultural technology are those who are already on right tail of distribution of disadvantage--that is, the readiest for change. Sadly, the poorest of the poor are often most immune to innovation.

3. Incentive effects. Providing the inputs and creating the outputs changes incentives so that unanticipated consequences occur.

(a) Many unanticipated negative consequences of anti-poverty programs involve substitution effects. When the price of something is changed, people substitute something else for it or produce less of it. Or they may decide to do something that you don't anticipate.

Some policies and programs that create new incentives. If being poor or unemployed brings benefits, people may seek to obtain such a classification or, more generally, not seek as assiduously to escape it,

(b) I have been interested in another variation, when anti-poverty efforts create incentives for corruption. A heuristic formula for corruption is this

$$C = M + D - A,$$

or corruption equals monopoly plus discretion minus accountability. If a policy grants officials monopoly power over a good or service plus discretion about how much of that good or service a client gets, and accountability is weak, corruption may easily emerge. Programs may also create incentives for service recipients to be corrupt. Many anti-poverty programs tend systematically not to anticipate such phenomena.

4. Self-fulfilling prophecies. Anti-poverty programs often require the poor to be classified in what society deems a negative way--for example, as impoverished, disadvantaged, discriminated against, unhealthy, homeless, or slow in learning. Sometimes such classifications take on a life of their own. The Pygmalion effect, so named by Robert Rosenthal, states that when you start treating somebody as an X, an X is what that person starts to become and, sadly, to remain. This effect has been controversial, not so much as to its existence (although Rosenthal's original study, involving teachers who were told that certain students chosen randomly were slow learners and then treated them differently, leading to such students becoming slow learners, has been convincingly critiqued), as to its size and permanence. The Pygmalion effect has been documented, but the effect size is consistently very small. This does not keep it from being a favorite of most people interested in fighting poverty--thus the automatic lamentations about the negative consequences of programs that create stigmas, stream students or clients, or take cultural differences into account. A relevant and fascinating separate question is: under what circumstances could treatment-by-client mismatches be reduced precisely by making such distinctions and changing treatments accordingly?

5. Insufficient attention to the economics of the institutions that must implement anti-poverty programs. The if-then statements are only true if the institutions through which inputs and outputs are mediated have appropriate information and incentives.

This is the category of unintended consequences that I want to emphasize, and which I meant the four cases to illustrate. Market-based reforms may have unanticipated negative consequences when the weaknesses of existing market institutions are not understood, and these weaknesses include (among other things) structures of information and incentives that handicap the poor. Democratic reforms, and efforts to redistribute opportunities and resources to the poor through public institutions, will also tend to fail the poor when those institutions malfunction because of bad information and inappropriate incentives. One way of putting my point is this: Anticipate that without institutional reforms, some of our noblest efforts to make markets and governments work better have consequences that disadvantage the poor.

Institutional Adjustment

There is a positive side to this observation. There are examples and there is economic theory to support the idea that the institutions of both market and state can be improved so as to serve the poor better. If the 1980s was the decade of structural adjustment in the sense of macro reform, and of democratic reform in the political sphere, perhaps the 1990s will be the decade of institutional adjustment.

There are some interesting similarities between *structural adjustment* and *institutional adjustment.* One goal of structural adjustment expressed in microeconomic terms is something like prices should be proportional to marginal costs, or domestic prices for tradable goods and services should be more closely linked with international prices. The corresponding idea of institutional adjustment is that *incentives in institutions should be linked with measures of productivity.* This can be harder within bureaucracies than in markets, because as Mancur Olson has emphasized elsewhere, measurement is so much more difficult, especially in the public sector. But there is a similarity. Paul Milgrom has put it this way: "Efficient organizational design seeks to do what the system of prices and property rights does in the neoclassical conception: to channel the self-interested behavior of individuals away from purely redistributive activities and into well-coordinated, socially productive ones."[5]

The strength as well as the limitations of this economic intuition need remarking. Economics can help us understand market institutions and non-market institutions, and how to make them work better. But (as I have argued elsewhere) the economics of institutions is limited in its ability to provide much more than frameworks for analysis. For example, there is nothing remotely as detailed to apply to institutions as the computable general equilibrium models or econometric models that have been applied in macroeconomics.

And yet the difference in applicability may not be as large as it seems, if only because experience has taught us that from detailed economy-wide models we cannot confidently deduce detailed policy prescriptions. Several recent articles note the limitations of macroeconomic prescriptions. I think a fair conclusion is that when external and internal balances are way out of line or very unstable, when prices are very far from anything that looks like a fair market price or an international price, then economists can give some pretty powerful advice. Despite the theory of the second best, we can say you have to move closer to balance and closer to market prices. But in other areas, despite macroeconomic models galore, humility is appropriate. Economists disagree about the details of structural adjustment, such as the timing and magnitudes of the reforms. Indeed, regarding the need for reforms if deficits are "pretty small" and prices

[5] Paul Milgrom, "Employment Contracts, Influence Activities, and Efficient Organizational Design," *Journal of Political Economy,* Vol. 96, No. 1 (February 1988), pp. 58-9.

are only "somewhat distorted," many economists profess agnosticism.

Similarly, in institutional economics I think we can say that even if we don't believe in our heart of hearts that the best-functioning medical system would have doctors being paid according to how successful the operation is, still we consider that in most developing countries we've got to be off the charts when people are being paid salaries they can't live on, with no connection to productivity. Similarly, when corruption is systematic and infects systems of justice--in contrast perhaps to opportunistic corruption that may resemble a tip for a private service--it is economically pernicious and requires strong remedial efforts. These kinds of institutional problems we know will lead to negative "unanticipated consequences." But regarding the details of sequencing and specifics of institutional reforms, or what to do in less extreme cases, our insights are much less clear and our advice, correspondingly, should be much more humble.

There are, then, similarities between structural adjustment and institutional adjustment in both the goals of economic reform and the applicability of economic models. But there are, it seems to me, important differences between structural adjustment and institutional adjustment in the ***processes*** of ***reform*** and in the possible roles *of* international institutions such as USAID.

Consider the structural adjustment program undertaken by President Paz Estenssoro's government in Bolivia in 1985. It's only a little bit of an exaggeration to say that ten guys in the back room with the president could decide what to do. And the president could sit down and sign something and it was done. You could devalue the currency, you could change the tariff rates, you could decontrol prices, and things would happen. But things are different for the types of reforms we're talking about. How do you decentralize the bureaucracy? How do you get people to be involved in the process of setting up new incentives and information? The process has to be much more participatory and much more experimental. The president can't do it by himself. The process is broader and slower.

Another contrast concerns the perception of credible, once-and-for-all changes in policy. A crucial dimension of the success of structural adjustment programs, it has been argued by Barry Weingast and others, is the credibility of the commitment of the new regime to the policies announced. Credibility involves the perception of permanence. If the policy is thought to be readily changeable, perhaps it will not be believed, and behavior will not change, investment will not increase. So a crucial aspect of macro reforms such as structural adjustment is how to make a credible commitment to then permanence.

The situation may be quite different in the case of incentive reforms in the public sector, one part of "institutional adjustment." You may only be able to get the public sector workers on board for changes in their incentives, if they think the change is not necessarily once for all, that it's experimental, that they will have a chance to see after two years how it's working.[6] So the dynamics of reform are different. In the case of structural adjustment the reforms must often be system-wide, immediate, and perceived to be permanent. In the case of some institutional reforms, it is better to begin with experiments in some parts of the system, changes perceived to be things from which we learn and then make further changes.

I will note that both structural adjustment and institutional adjustment must overcome many enemies,

[6] There is, however, a similarity to the structural adjustment case in the need to deal with fears of "ratchet effects." If employees feel that incentive experiments may later be used to "ratchet up" the expected levels of performance with no later gains in pay, they may resist the whole process of reform. Credible commitments need to be made that pay will be linked with the value of what is produced, not to output measures that are subject to arbitrary recalibration by management.

and some of those enemies are surprising--perhaps some of the people a naive outsider would expect to be allies. In the case of economic liberalization, it was development economists of certain stripes who opposed it: people who loved the Albanian-style planning models, the United Nations "experts" who wrote their own five-year country plans for UNDP aid, and those who thought of development policies as a bunch of projects ordered in priority. These were people who did not intuitively favor the idea that you could reform an economy by restoring internal and external balances and by getting prices right. And similarly, in the case of the adjustment of public sector institutions, some of those most opposed to the approach I have outlined are the very people who are deemed experts in public administration. To suggest that better information, performance-based incentives, and more decentralization based on results are the keys to institutional reform flies in the face of their penchant for plans. projects, and moral exhortation instead of material incentives.

What is the role of an agency like USAID in reforms of the two types? In the case of structural adjustment, the paradigm for a long time involved conditionality: "We will give you aid if you undertake such-and-such a reform (and we'll help you design the reform)." With institutional adjustment, many Ministers I've worked with have an opposite impression, that the donors will never allow this kind of reform but prefer to send their experts to do studies and plans. I believe a key role today of outside agencies is to help legitimate institutional adjustment, such as the idea of that governments can and should experiment with better incentives. An agency like USAID could suggest that we'll not only allow such experimentation, we'll encourage it--in fact, we'll share some experiences with our own state and local governments using innovative ways to measure the performance and productivity of government.

In any case, I am convinced that we need not continue facing "unanticipated consequences" in our anti-poverty efforts. Part of the task is to be smarter, so that we can anticipate and then adjust. Another part is institutional reform, so that the market and government institutions that carry out anti-poverty programs themselves have the information and incentives to make such programs work.

QUESTION AND ANSWER PERIOD

Q: I've read that often pilot projects that try to have good incentives and so on tend to be successful. But when the projects get expanded on a national or a larger scale, things don't work out so well. Do you see something general that distinguishes the cases where changes works on a large scale? For example, credit programs. I know that in India, for example, the pilot projects were often much more successful than when they were expanded.

Klitgaard: Take the case of an integrated rural redevelopment program. To get good people, we hire the best people and pay them what we need, and our project works. Now the government comes along and they say, that project works, but we can't pay these people three times what others are getting. So the wage goes down and the good people leave and the project that doesn't work so well. That's the way I think about it: That the mistake is that we don't think about linking the pay to some performance measures, so that it becomes justifiable and sustamable. We can combat the propensity to think in terms of horizontal equity within the public service if we can say the reason we're paying these people this much is because they're moving the money out there and it's still only 4 percent of the total for overhead, compared to 7 percent for **UNDP.** Then the opponents of incentives have little to say. J. Edgar Hoover used to go to Capitol Hill and say "For every dollar you give us at the FBI we save you four." Congress liked that. They could say, "We pay the guy, but he gets us four back." So we've got to come up with something like this to justify sustainably better incentives.

Q: I think an implicit theme of what you're saying is that we have to put in modem institutions. And I wonder if there aren't some traditional institutions which deserve respect and strengthening.

Klitgaard: That's an area I'm working on now: how can development efforts take local institutions into account? It's clear the unanticipated consequences side, that many times when we try to get rid of traditional institutions such as sharecropping or patron-client credit relations, we find that market institutions do not automatically appear. So it's quite clear that the transition from traditional to modern is more than trying to jettison and replace existing institutions. How can we (including "they") adapt to traditional institutions and how do such institutions undergo change? Sometimes the issues become very difficult. For example, under what conditions would existing hierarchical, sexist, nonparticipatory institutions in the village be nonetheless desirable? Under what conditions do you say, "Oh, my God, we can't work through those kinds of institutions and accept that status quo?" So there are some fundamental tradeoffs here. But I do share your concern, and I don't mean to be implying that the only institutions worthy of attention are modern market institutions.

Strategies for Growth and Poverty Reduction[1]

Jagdish Bhagwati

I am going to return to less institutional issues, after listening to Klitgaard's fascinating agenda for what we don't really know and what we're going to get into. I am glad that I'm not in that game, because I don't even know how onc would begin to come up with the hard answers. The questions are hard enough. What I will talk about is my own experience in developing countries, particularly South Asia, and return to the title the "Paradoxes of Poverty."

Paradoxes are paradoxes as long as you haven't resolved them, but I'd like to talk about some of them that were resolved, where we do know the correct policies, particularly on the macro side. The main one which I would like to focus on is the whole question of the relationship between growth and poverty, The notion that growth would in fact contribute to poverty used to be very prevalent. There was a fear that the green revolution would bring about polarization in society, which would lead to the red revolution. These kinds of assertions are about a decade old. A lot of them came from US-trained people who still persist in India in some degree, bedeviling reformers. India is a country where in addition to the iron triangle of interests, opposed to reform, you've got a fourth wheel of the coach, and that's the economists.

Eventually in the 1970s and early 1980s there was a powerful move towards the idea that growth was really antipoverty. There is probably a consensus throughout India, and probably in South Asia, and maybe even more widely that growth is a tremendous force in eliminating poverty; it is really essential. Apparently the notion that growth can be inmiserizing has fallen by the boards. The data which Chris Clague quoted from the Drèze-Sen book supported income-led attacks on poverty. When you grow, you create jobs. The idiotic phrase, trickle-down, suggests a spill-over effect that just happens inadvertently. When we were planning in India in the 1950s, we were thinkin'g of growth as the natural strategy, as- a pull-up strategy, not as a trickle-down strategy, not as a conservative option but as a radical option. We had in mind rapid accumulation to pull people on board from underemployment.

There is something that bothers me about the Sen-Dreze approach, when you look at that table that Chris Clague reproduced from them. Can you sustain such improvements in social indicators in a country like Cuba or Sri Lanka when you have negative growth rates? There is a symbiotic relationship between growth rate and distribution at very low levels of income. You really have to ask over sustained periods if you really want to spend a lot of resources to try to have a direct impact on poverty or to follow the indirect one of growing, creating jobs, and increasing income and consumption. Of course, there are problems and tradeoffs. In the 1960s and 1970s, we underestimated the extent of complementarily as well, the fact that you could have growth and equality together. So I would say that a country like India that emphasized redistribution more had a whole lot of instrumentalities that really hobbled growth, and ultimately weakened the system itself in terms of availability of resources. Even if you believe in the direct mechanism, ultimately if you don't grow, you're in trouble, and that's why we need to look at the problem as one that cannot be solved in relation to immediate impact effects.

And ultimately even if we get income to people, then you still have to worry about problems related to how different social groups have different consumption patterns and values. There's a folk story about a sailor inheriting money, a very large fortune. And he spent a third on gin, a third on women, and he

[1] *Draft transcript. Do not cite or quote without permission of the author.*

frittered away the rest. You can give people money and it doesn't necessarily translate into living standards, unless we define living standards fairly elastically compared to our Puritanical approach to these matters.

Whatever resources you invest in either the direct or the indirect method, you want the maximum return, and you want also to bias the growth process itself in terms of its impact on the poor. There are different kinds of growth processes, and that's where I'd like to get into institutions and the problems that have been raised. For growth -- and let me put it in terms of increasing the returns to any given investment -- I think that the first thing that we have learned concerns the role of markets.

This idea goes back to Adam Smith, who was deeply against the businessmen's arena and at the same time was for laissez-faire. Smith's views seem at times contradictory, but that is because in his time, businessmen did not have the framework within which "their self-love which exceedeth the love of profits" could be harnessed by society in an institutional framework to create public goods. In Smith's time in fact there wasn't real democracy. Adam Smith himself couldn't vote, because of restrictions based on property holdings. David Hume couldn't vote. It is unbelievable that these two of the great men of the time could not vote. It was an oligarchic. non-participatory system in which mercantile and other special interests really controlled everything. Therefore the drive to self-improvement, profits, self-love -- because of the institutional framework being wrong, both political and economic -- was producing bad outcomes. Smith was suggesting a shift to markets as a way of producing good outcomes.

The fact that democracy is breaking out is beginning to change the picture, but I think the fundamental contribution of Adam Smith applies even more to developing countries today than to developed ones, if you think of him in the right perspective rather than think of him as a conservative reactionary. If you really read Smith correctly, you see him as a revolutionary for his time.

Other things like property rights, which are somewhat complementary to markets, are also terribly important to development. An outward trade orientation also contributes to development; the impact of becoming part of the world economy is benign rather than malign. On a theoretical level, it doesn't have to be, but I think that all the evidence shows that countries that did integrate more rapidly in the world economy than others have done better. Economists can create all kinds of models and do anything with them, logically, if they're smart enough to have made the right assumptions. Those who used models that produce arguments for import substitution turned out to be wrong, in my empirical judgement, not my ideological judgement or theoretical judgement. There are plenty of cases of countries doing very well, even in the early historical period, after they gave up being closed. Unlike President Clinton, Commodore Perry managed to impose free trade on Japan, in the old days. The British did without protection. The US developed industry and had reasonable growth rates in the 19th century and early in the 20th without having a government that was responding to coalitions and groups. So/it's not just Hong Kong today that shows the value of open markets. One can look at historical cases. Whatever the theoretical case concerning open markets, the empirical case is a lot stronger, and ultimately anybody who looks at it will be converted, just as India and South America have been converted.

The role of primary education is terribly important in growth. In my view, countries like India did not effectively promote it for social reasons. Despite the stated intentions on the part of the government to have an emphasis on literacy, it wound up with about a 30% literacy rate m reality. Primary education has no relationship to economics; it has to do with a love of social ideas. Confucianism did it in the Far East, Martin Luther did it for Scotland and Prussia, even though they were way behind other countries in per capita income. This is a complex issue that goes beyond simple economics, but it has economic consequences. I think that it is certainly part of the Indian story of the heavy hand, which we are getting out of now. There have also been a lot of studies now to show that women's education makes an enormous difference to growth.

Where I would disagree with Olson a little bit, or would complement his very interesting analysis of the role of special interests, concerns the role of ideas or ideologies. Whichever term you want to use, they explain the fact that a lot of countries went into the wrong macroeconomic policies, not macro-macroeconomic policies, but the non-Klitgaard policies. These policies were chosen because of ideas about export subsidies or import substitution. I think that it matters an enormous amount in developing countries, what in fact is the set of ideas in which we want to operate. In India, there was a sort of statist thinking that defined an orientation toward guiding investment allocation, actually going in and saying that we should invest in X rather than Y. All of us were brought up on that kind of investment allocation policy, because it was the frontier of developmental knowledge. So many of these ideas were picked up, directly affecting policies, and then that defined the institutions that arose. And that developed in turn the interests and coalitions that Olson described. The bureaucrats were in love with the interventionist policy, naturally, the politicians realized they could make a lot of money with it, and the sheltered industries loved it, too. And then the idea changed to reform, to liberalization, and so on. And then you have to confront that iron triangle of interests, and that becomes a problem. But if you see the sequence through which these interests were formed, we cannot absolve ourselves of the problem. John Williamson has this fascinating book about "technopols." technical politicians. They can be part of the historical evolution of the kind that I was describing.

In terms of the conditionality issue in the role of international institutions, you can nudge things in the right direction or in the wrong direction, using incentives or punishments. I think that international institutions provide a different kind of actor on the scene in terms of the interplay of coalitions. This can be seen in trade policy and a variety of other reforms. There is the question of how you fine-tune the pressures, which is the kind of thing we have to face in dealing with China today. I think that exactly how you play it is one of the hard ones, but certainly external agents are extremely important to developing countries unless they are totally isolated. However, you can't go to a government and say institute that and reform this, when, in fact, the government depends upon not having the reforms. But it's something in which we can recognize, as it were, the facts of life, and maybe put a little pressure in the right direction.

I think that we have also learned from experience in regard to the role of democracy in relation to growth. The favored view, when we were writing early on, was that democracy was a handicap to development. Those of you who are my age will remember that when the US was thinking about India and China in the 1950s and 60s, India was the country that was supported because it was a democracy and China was totalitarian -- nothing much has changed in that regard, actually, except which is getting support. At that earlier time it was not only the identification with Indian democracy that guided US policy, but also the fear that India needed support because China would grow faster because as a totalitarian country, it could accumulate capital far more quickly. It was assumed that the capital-output ratio would be the same across countries -- a technological datum -- so that it was feared that totalitarian countries would grow much faster than democracies.

However, the fact that you have incentives and participation affects how much you get out of what you invest. That's where democracies come out ahead, in my view. There's a lot of work now by John Helliwell, a colleague on the political science side, which contradicts the notion that somehow democracy doesn't correlate with development. I think democracy really is an instrument for development; sometimes good things do go together. Politics therefore isn't Just blood, sweat, and tears and getting more and more resources. The collapse of the Soviet Union shows that it is really what you get out of what you invest that matters.

All of these things matter for reaching the poor effectively. Markets certainly are important to that, because one of great lessons of the last 20 years was that when you allocate through the market, the poor have a much better chance of getting at resources compared to when the state does the allocation. When the state does it, it usually goes to the rich. And that, again, is a simple political fact of life, particularly in feudal countries. The economic reasons Olson described, such as coalition formation, would add to it. Many of us who thought that government regulation or intervention was required for equality and for reaching the poor were just shocked when we saw that the big guy could pick up the phone and get to people who were handing out things. The little fellow never had a chance. He didn't even have a phone. He couldn't get past anybody at all to get his licenses and quotas and so on.

This realization was a very defining moment in people's thinking. For those of us that came from left of center, as I was at one time, it was a revelation that very little of what we had thought would work for equality and the elimination of poverty worked like we thought in the classroom. Reality was much more complex. So to say again, we've come to recognize that markets are a very powerful tool in development. They still lead to unequal outcomes, of course, but the other ones are worse: it's the Churchillian point, they are the best thing we know. Now, the initial distribution of assets also matters a great deal and poses a lot of problems for reform. Korea and Taiwan did very well, as you know, in part because the initial distribution of assets was relatively equal. They already had land reform in place in a big way, thanks to Japan. Therefore, I think that despite their tough, draconian regimes, the egalitarian impact of whatever they did was much greater than in countries that started out with a very unequal distribution of income.

Primary education is also, in my view, a factor in improving income. It's also a great equalizer. It preaches social mobility, and since it is not just equal outcomes which we think about, but equal opportunity and equal access, rather than equal success. I think that the lack of primary education is the most terrible handicap in countries without it. The lack of it has certainly impeded social mobility in my country, India, So I think primary education is a very defining thing. In the 1960s there were theories about how more feudal, more unequal countries in fact went for higher education rather than primary education. Equal participation in education can make an enormous difference to gender equality within the family, to nourishment, and improving living standards. Also, the rethinking of population control issues obviously depends very much on the ability of women again to participate.

And then within the family we know from a number of studies that women don't eat as well as men do, that female infants are allowed to die more quickly in times of scarcity. So those kinds of things require additional instruments, not just growth or just biasing growth. Ultimately these are the areas in which we need to think of growth in a more detailed way. But I think the basic lesson still remains, and which really needs to be emphasized again and again, is that growth does matter. It's important to have adjustments with a human face, but if you don't have adjustment at all, you'll be off the board. And once you have adjusted, you've generated the revenues, then you can indulge more in redistributive policies. But I think that a lot of people tend to think that anybody who worries about growth, or that anybody who worries about getting more out of investments, is somehow interested in growth per se and doesn't really understand poverty. That's ridiculous, in my opinion.

I remember after giving a speech, a man called Luis Aparicio -- who used to run the OECD's development center – actually came up to the dias and said "It's good to see that the Professor Bhagwati is now finally talking about poverty." And I said, "I beg your pardon ? Just yesterday I was looking at the first book I ever wrote, in 1966, and like you I thought my first chapter would be called 'Growth' but I was surprised when I found it was called 'Poverty and Income Distribution."' And then I told him that I was criticized widely at that time. John Chipman told me that people had come up to him and said, "Bhagwati has gone mad because he used a picture of a starving child in that book." If you were ever identified with thinking about efficiency, you were immediately thought to be incapable of thinking about poverty and income distribution. Growth and the elimination of poverty are not at all incompatible in my view, and one is an instrument of the other. Certainly! in very poor countries with a large malnourished population, there is no way outside of growth and increased efficiency of generating the resources to have an impact on poverty.

QUESTION AND ANSWER PERIOD

Q: Professor Bhagwati, do you think it's possible to have sustained growth for 25 or 50 years in countries without raising equality?

Bhagwati: Without raising it? Theoretically it is, but has it ever happened? I wonder. It certainly hasn't happened in the Far East. I think part of the reason may be the relation to democracy. Today there is both globalization and pressures from outside from human rights groups. In Germany, et cetera, the growth of merchant classes led to the advance of democracy and today, in a slightly modified form, that does still seem to happen. Once you get democracy, then it tends to introduce some of these policies I was describing. Even in authoritarian regimes, I think there is a kind of long-term process which would tend -- by destroying the proletarianism -- to produce a better economic outcome. This sounds like too rosy a picture, but this is based on very detailed political argumentation and evidence. I've written on this in the ***Journal of Democracy.***

Clague: I'll ask a question from my notes. I tread on very dangerous territory here, but I thought you were a little too rosy about the relationship between democracy and growth. You cited John Helliwell, do you take the position that the relationship is a neutral one.? If you take the position that democracy is universally favorable to growth, then you can't cite Helliwell to support that. It's a very politically incorrect position to take, but I think that honesty compels us to note that in order to bring about a dramatic reform of institutions, in order to change the rules of the game, we need a government with a certain degree of staying power, a government that can last through some bumpy places in the road, until the fruits of the new policies come in. That doesn't rule out democratic government, and I think that democratic governments that have carried out reforms tend to be ones that have been given a window of opportunity, a certain time period within which to launch an entire program and reap the benefits of it. It is also the case that authoritarian governments have that window and sometimes even have room to make a few more mistakes along the road. In the Far East, for example, there was a definite relationship between the government's authoritarian character and the policies they were able to follow. For example, governments were able to follow the policy of holding wages very low, which was quite beneficial to competitiveness and investment, and that was the result of very frank labor-repressing policies.

Bhagwati: I would not say that it was wage-labor repression or anything like that that led to growth in the Far East. It had a very high literacy rate, an ethos about catching up with the outside world, protection that was for a change was productive of good results rather than bad results. Where protection will work is where there is learning by doing. In my view, protection will work if there is a national ethos of catching up, coming up with world-class industries, setting your sights on international standards and developing export industries rather than goofing off, which is the usual model for the rest of the world when you get protection. And that was combined with very high literacy rates, which come from again primary education. All of that combined to make the Far East very effective. It had nothing to do, in my opinion, with the fact that the regimes were authoritarian. Particularly/since they were authoritarian, they could have chosen bad policies, too. But their policies reflected societal values.

I agree that you would not be able to find a very strong relationship between democracy and growth. But the evidence at least contradicts the view that democracy is adverse to development: in my view, democracy is conducive to development. There could be exceptions over short periods.

Klitgaard: Getting back to the number-crunching, Gerald Scully's new book "Constitutional Environments and Economic Growth" takes a look at policies in 115 countries, and finds that democratic countries do better. A country at the 25th percentile of political rights has an annual growth rate about 1.4% higher than one at the 75th percentile. There's been another study in the *Journal of Political Economy* corroborating Scully's work.

Q: I think that it's a credit to the economics profession that we're now beginning to deepen and broaden the discussion of the relation between democracy and some measures of economic performance. On the other side, we have looked at some work by Ron McKinnon, for example, who disaggregates economic liberalization. I'm wondering if the next step in research on the relation between democracy and economic performance might be disaggregation of democracy, and we might come up with some notion of the optimal order of political liberalization.

Klitgaard: I've been working in this area recently. There have been studies that disaggregate political rights, for example, but when you take these apart and look at each one with different outcome measures, including growth, it turns out that the aggregate is the same thing. In other words, civil rights and political rights are correlated about .9. At least with the measures that we now have, which aren't very good, I'm not sure that disaggregation will work. This is surprising to me, since I would have thought that some rights were more important than others. This may reflect some underlying variable I'm not measuring.

Q: It seems to me that one area where non-democratic countries in underdeveloped countries may have an advantage is fiscal policy. We see this in the United States. The real problem of elective government is keeping G minus T within reason. In other areas, I suspect that it's right that democracies and good policies go together. To move onto the correlation mechanism, causation could run either way unless you have causation tests to flag it. i.e., countries that are wealthy and growing faster can afford and choose democracy.

Williamson: I think that there is a very clear and strong relationship that capitalism comes first. One of the more convincing studies I've heard had it both ways on democracy in the past decade; it came out with a positive relationship, which is good news, and bad news was that it wasn't statistically significant.

Q: Toward the end of your comments, you said that growth with a human face was important, not just growth. Obviously, USAID is trying to have growth with a human face. I wonder if you would mention some of the important to-dos and not-to-dos concerning what a "growth with a human face strategy" might be. You mentioned primary education as one.

Bhagwati: Those are the lessons we have from all of these studies now, about the role of women, the role of primary education, promoting democracy -- those kinds of issues are very important. The challenge that I'm a little bit worried about, which I raised with Carol Lancaster this morning, is that we're trying to transplant our cultural norms, like our specific views on labor standards. That could be counterproductive. There are complicated issues in translating minimum wages, et cetera, and such moves could create more inequality, less accumulation, and, in my judgement, less impact on poverty simply because of most of the poverty is outside those sectors where such measures would be effective -- in rural areas, for example. Without probing those issues more carefully, taking institutional design into account, there is some danger that sensible, good ideas on the environment -- for example -- could be counterproductive. I think that on the whole, USAID has a good agenda, and certainly with much more knowledge and experience than we had 30 years ago when we worked with a priori models, many of which were quite wrong.

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Professor Bhagwati has published more than two hundred articles and over thirty volumes. Regarded as one of the foremost international trade theorists today, he is best known for his seminal work in the 1950s and 1960s on the theory of commercial policy. He has also made notable contributions to developmental theory and policy, public finance, immigration and, starting in the 1980s, to the new theory of political economy.

His early books, *India: Planning for Industrialization* (with Padma Desai, 1970) and *India* (with T. N. Srinivasan, 1976) are acknowledged to have provided the intellectual case for the major economic reforms now under way in India. His latest book, *India in Transition,* was published in June 1993. Among his recent books are: *Protectionism* (1988), an international hentneller in several languages. and *The World Trading System at Risk* (1991).

Professor Bhagwati also writes frequently for *The New York Times. Wall Street Journal* and *The Financial Times* and reviews for *The New Republic* and *The New Leader.* Professor Bhagwati founded in 1971 the *Journal of International Economics,* the premier journal in the field today, and *Economics and Politics* in 1989.

Professor Bhagwati is a Fellow of the Econometric Society and of the American Academy of Arts & Sciences. He holds honorary degrees from South Gujerat (India), Erasmus (Netherlands) and Sussex (UK) Universities. Among the awards he has received are the Mahalanobis Memorial Medal (India), the Bernhard Harms Prize (Germany), and the Kenan Prize (USA).

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Professor Clague has written numerous articles in the fields of international trade and economic development. Among the topics on which he has worked are the determinants of productivity differentials among countries, the trade effects of tariff preferences, the theory of capital utilization, and the relationship between purchasing-power parities and exchange rates. Recently he has become interested in the New Institutional Economics and has done research on the influence of institutions on the comparative advantage of nations. He has also worked on the economics of the transition from communism to a market economy, focusing particularly on the institutional aspects of this transition.

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Adjusting to Reality: Beyond "State versus Market" in Economic Development, a study of policies to make markets work better, make governments work better, and close the economic gaps among ethnic groups, using case studies and many examples from Latin America and Asia.

Tropical Gangsters, a first-hand account of free-market economic reform in Africa, and was named by the editors of the New York Times Book Review as one of the six best non-fiction books of 1990.

Controlling Corruption, a study of corruption and how to reduce it in the developing countries, including case studies of the Philippines, Hong Kong, Singapore, South Korea, and Pakistan.

Elitism and Meritocracy in Developing Countries, a comparative and analytical study of selection policies (including affirmative action) using detailed examples from China, Indonesia, Pakistan, and the Philippines.

Professor Klitgaard is currently in the midst of a multi-year research program on how development policies and management might be improved by taking cultural pluralism into account, with a special focus on Africa.

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Some IRIS publications related to the **themes of this conference include:**

Jean-Marie Baland and Ashok Kotwal, "The Political Economy of Underinvestment in LDCs", IRIS Working Paper No. 125, August 1994.

Christopher Clague, "Rule Obedience, Organizational Loyalty and Economic Development," *Journal of Institutional and Theoretical Economics,* June 1993. IRIS Reprint No. 28.

Christopher Clague, "Bureaucracy and Economic Development," IRIS Working Paper 110, June 1994.

Philip Keefer and Stephen Knack, "Why Don't Poor Countries Catch Up? A Cross National Test of an Institutional Explanation," IRIS Working Paper No. 60, June, 1993.

Philip Keefer and Stephen Knack, "Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures," IRIS Working Paper No. 109, May 1994.

Robert Klitgaard, "Institutional Reform and the Challenges Facing South Africa," IRIS Working Paper No. 112, June 1994.

Robert Klitgaard, "Do Better Polities Have Higher Economic Growth?" IRIS Working Paper No. 113, June 1994.

Mancur Olson, "Agricultural Exploitation and Subsidization," Choices, Fourth Quarter, 1990. IRIS Reprint *No. 22.*

Mancur Olson, "Dictatorship, Democracy, and Development," *American Political Science Review,* September 1993. IRIS Reprint No. 32.

Mancur Olson, "Why Are Differences in Per Capita Incomes So Large and Persistent?" *Economic Growth in the World Economy,* Symposium 1992, pp. 193-214. IRIS Reprint 41.

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